



Briefing Paper

The Price of Offshore

Summary

Our research suggests that:

- Ø approximately US\$11.5 trillion of assets are held offshore by high net-worth individuals;
- Ø the annual income that these assets might earn amounts to US\$860 billion annually;
- Ø the tax not paid as a result of these funds being held offshore might exceed US\$255 billion each year.

Offshore wealth

Data on the value of wealth held offshore is hard to come by since neither governments nor the international financial institutions seems either able or willing to research the global picture.

The Bank for International Settlements (BIS)¹, an institution controlled by banks, records bank deposits by country. According to their estimates, in June 2004 offshore bank deposits totaled US\$2.7 trillion offshore out of \$14.4 trillion total bank deposits. This means that approximately one-fifth of all deposits are held offshore².

However, this figure relates solely to cash. It excludes all other financial assets such as stocks, shares and bonds, and the value of tangible assets such as real estate, gold and even yachts held offshore as well as shares in private companies. These assets are typically controlled through offshore companies, foundations and trusts, the latter not even being registered let alone required to furnish annual statements of account. The value of these assets is therefore unknown and harder to determine.

In 1998, Merrill Lynch / Cap Gemini's 'World Wealth Report' estimated that one third of the wealth of the world's high net-worth individuals (HNWIs as banks refer to them) is held offshore. According to their most recent wealth report, the value of assets held by HNWIs with liquid financial assets of \$1 million or more was \$27.2 trillion in 2002/3, of which \$8.5 trillion (31%) was held offshore. This figure is increasing by approximately \$600 billion annually, which brings the current figure to about \$9.7 trillion.

A slightly lower estimate was published by the Boston Consulting Group (BCG)³ in their Global Wealth Report for 2003. BCG estimated the total holdings of cash deposits and listed securities of HNWIs at \$38 trillion, which is broken down by geographical region of origin as follows:

Continent	Total wealth \$ trillions	Probable amount in offshore \$ trillions ⁴
North America	16.2	1.6
Europe	10.3	2.6
Mid East and Asia	10.2	4.1
Latin America	1.3	0.7
Total	38	9.0

These figures exclude real estate, non-financial assets and privately owned businesses.

There is a third way of estimating the value of liquid assets held offshore. Data published in a report⁵ by the research arm of the global consulting group McKinsey & Company, shows that the total global financial capital amounted to \$118 trillion in 2003. This was split by asset type as follows:

Asset type	Value \$ trillions	percent of total
Quoted Equities	32	27
Private bonds	30	26
Gov't bonds	20	17
Bank deposits	35	30
Total	118	100

Whilst it might appear hard to reconcile the McKinsey figure for deposits with that of the BIS, it should be noted that McKinsey's figure apparently includes the balances banks owe to each other which are not included in the BIS data quoted earlier. This means that the BIS data is a reflection of the sums held by individuals, non-banking corporations and trusts and is therefore more accurate for these purposes.

The ratio of cash to total financial assets has, according to McKinsey's, ranged between 3.3 to 3.85 over the past 4 years. An average of 3.5 would seem reasonable. Applying this average to the BIS offshore holdings yields a figure for total financial assets held offshore amounting to \$9.45 trillion. This provides a third estimate within the range \$9 to \$10 trillion.

However, this estimate does not include real estate and other tangible assets, the ownership of private businesses held offshore, or other intangible assets such as the rights to receive royalties and licence fees. No one can be sure of the precise value of these assets, so use a modest estimate that they would add no more than \$2 trillion to the value of offshore holdings (which in view of the value of real estate may well be very modest indeed).

This provides the basis for our estimate that the value of assets held offshore lies in the range of \$11 - \$12 trillion. We consider this to be a conservative estimate.

Income from offshore wealth

According to the various wealth reports already referred to, wealth holders currently expect their assets to grow at between 7 and 8 percent annually. An average rate of return of 7.5 percent would therefore seem appropriate.

US\$11.5 trillion invested at 7.5 percent yields a return of about US\$860 billion a year. This is a reasonable measure of the offshore investment income each year.

Tax lost on offshore income

The tax loss arising from \$860 billion being held offshore is estimated as follows. In 2003 Cap Gemini stated that 7.7 million people around the world held more than US\$1 million in financial-asset wealth. Normally these high net-worth individuals would be paying the highest rates of personal tax. Forbes magazine in 2004⁶ stated that the average marginal tax rate for a person earning €100,000 that year was 37.5 percent. However, this figure would be too high an estimate of overall tax losses since some assets held offshore will have been invested in ways that involve taxes being withheld from payments made. We estimate that the average withholding on a portfolio of the type Cap Gemini refers to would be in the region of 7.5 percent. On this basis we use an average tax rate of 30 percent to calculate the overall tax loss.

\$860 billion at 30 percent yields an annual tax loss of approximately \$255 billion resulting from wealthy individuals holding their assets offshore.

This estimate does not include tax losses arising from:

- Ø tax competition;
- Ø corporate profit-laundering.

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Notes and references

¹ <http://www.bis.org/>

² Data confirmed by BIS 1-3-05

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<http://www.bcg.com/publications/files/WealthJul03website.pdf>

⁴ These figures have been computed by the Tax Justice Network based on the mid points of the estimated ranges of assets held offshore

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http://www.mckinsey.com/mgi/publications/gcm/executive_summary.asp

⁶ <http://www.forbes.com/global/2004/0524/082.html>